SABAH DEVELOPMENT BANK BHD.

v.

S.K.B.S. (SABAH) SDN. BHD. & ORS.

HIGH COURT BORNEO, KOTA KINABALU
SYED AHMAD IDID JC
[CIVIL SUIT NO. K364 OF 1986]
17 SEPTEMBER 1991

BANKING: *Letters of credit and revolving credit line advanced by plaintiff company - Whether banking license required - Whether conducting banking business - Purpose of organisation - Activities of a 'bank' - Consent of Finance Minister to use word 'bank' - Transactions involving foreign exchange - Regulated by Bank Negara - Transaction not disapproved by Bank Negara - Banking Act 1973, ss. 2, 3, 9 - Banking & Financial Institutions Act 1989, ss. 2(1), 3.*

The plaintiff (SDB), is a company incorporated in Malaysia set up by the Sabah State Government in 1971 to provide for medium and long term loans in Sabah to private and state enterprises to finance a wide range of activities on the agriculture, manufacturing, utilities and the construction of real estate sectors.

Upon the request of the 1st defendant (D1) and pursuant to two letters of offer, SDB extended to D1 advances and documentary import credit facility of RM300,000 and revolving credit line of RM200,000. The 2nd and 3rd defendants (D2 and D3) guaranteed on demand to pay SDB all sums up to the limit of RM500,000.

The issue for determination was whether SDB had transacted illegally under the Banking Act 1973 (the 1973 Act) as it was not licensed as a bank, and if so, whether the transaction was void pursuant to ss. 2(f) and 24 of the Contracts Act 1950 (the 1950 Act).

SDB argued that it had been duly authorised to use the word "bank" by the Minister under s. 9 of the 1973 Act; further that SDB's activities in this action was not "banking business" and therefore did not infringe s. 3 of the 1973 Act. Consequently, it was submitted that SDB did not require a banking licence under the 1973 Act.

Held:

[1] Even though a corporation or a company so described and registered under the Companies Act 1965 may have obtained consent from or is authorised by the Minister of Finance under s. 9 of the 1973 Act, such organisation is not a bank within s. 2 of the 1973 Act.

[2] To determine whether or not the facilities come under banking business one must see for what purpose the facilities were advanced.

[3] SDB was involved in letters of credit or trust receipts, transactions which involved foreign exchange which must be cleared with Bank Negara. It would appear that SDB is a scheduled institution as it carries out scheduled business of development finance business (ss. 2(1) and 3 of Banking & Financial Institutions Act 1989). In the absence of any evidence that Bank Negara or other regulatory authority has disapproved SDB's activities, it is presumed that SDB conducts its business in accordance with the laws and regulations of Malaysia and therefore it has not breached the Banking Act 1973 (or the Banking and Financial Institutions Act 1989 where applicable).

[4] On the evidence, SDB has not breached the law as it did not conduct banking business by lending to the defendant as it did not take current accounts, pay cheques drawn on itself and collect cheques from its customers.

[Plaintiff's claim granted.]

Cases referred to:
Bank of China v. Lee Kee Pin [1961] 1 MLJ 40 ***(cit)***
Bank of China v. Chew Kean Kor [1963] MLJ 41 ***(cit)***
Diversey (Far East) Pte. Ltd. v. Serba Pakar Kimia Bhd. Writ Vo. ix 1990-1991 p. 77 ***(cit)***
Haji Yahya Lampong, Re; Ex parte Sabah Development Bank Bhd. [1987] 2 MLJ 488 ***(cons)***
Roe's Legal Charge, Re [1982] 2 Lloyd's LR 370 ***(cit)***
Vernes Asia Ltd. v. Trendale Investment Pte. Ltd. & Anor. [1988] 1 MLJ 357 ***(foll)***

Legislation referred to:
Banking Act 1973, ss. 2, 3, 9.
Banking and Financial Institutions Act 1989, ss. 2(1), 3.
Contracts Act 1950, ss. 2(f), 24(a)

Other sources referred to:
Money and Banking in Malaysia by Bank Negara Malaysia, 30th Anniversary Edn., 1959-1989
Paget's Law of Banking (6th Edn.)

For the plaintiff - Lawrence Thien; M/s. Chau and Thien
For the defendants - Sugumar Balakrishnan; M/s. Sugumar and Co.

JUDGMENT

Syed Ahmad Idid JC:

The plaintiff is a company incorporated in Malaysia and has its place of business at Wisma Tun Fuad Stephens, Lot No. 3, SDB Tower, Karamunsing, Kota Kinabalu, Sabah.

Money and Banking In Malaysia by Bank Negara Malaysia, 30th Anniversary Edn., 1959-1989 has this to say:

> In 1977, the Sabah Development Bank Berhad was set up by the Sabah State Government to provide for medium and long term loans in Sabah to private and State enterprises. By the 1980's, the Agricultural Bank of Malaysia followed by the Sabah Development Bank (plaintiff here) emerged as the leading medium and long term credit institutions while loans by the Sabah Development Bank Berhad were extended to finance a wide range of activities on the agricultural, manufacturing, utilities and the construction of real estate sectors.

The plaintiff claimed against the 1st defendant for the sum of RM188,618.09 being outstanding documentary import and revolving credit facility as at 31 January 1986 extended by the plaintiff to the 1st defendant at the 1st defendant's requests under two letters of offer dated 30 March 1985 and 3 April 1985 respectively together with interest thereon at the rate of 17.5% per annum.

By a continuing guarantee in writing dated 2 April 1985 executed by the 2nd and 3rd defendant's in favour of the plaintiff, the 2nd and 3rd defendants guaranteed on demand to pay the plaintiff all sums up to the limit of RM500,000 in addition to such further sum for interest thereon and other charges, costs and expenses which should at any time be owing or remaining due and unpaid to the plaintiff from the 1st defendant.

The plaintiff also claimed against the 1st, 2nd and 3rd defendants statutory interest, costs and further or other relief.

At the hearing on 4 July 1991, Mr. Sugumar, on behalf of the three defendants, decided to argue only on one point, that is that the plaintiff, not being licensed as a bank under the 1973 Banking Act, had therefore transacted illegally. So the issue he raised was that the transactions, the subject matter of this action, were void pursuant to s. 24 of the Contracts Act. What Mr. Sugumar meant was that "the agreement(s) was/were not enforceable by law" (s. 2(f) of the Contracts Act 1950). He submitted that the object of the agreement was forbidden by law - s. 24(a) Contracts Act 1950.

The plaintiff's contention was that the loan was properly and legally extended to the 1st defendant and so recoverable in law. The plaintiff operates as a development bank and since 26 July 1978 the plaintiff had been duly authorised to use the word "Bank" by the Minister under s. 9 of the Banking Act 1973. The activities of the plaintiff in respect of the loan transaction in this action are not "banking business" and do not therefore infringe s. 3 of the Banking Act 1973 as they do not come within s. 2 of that Act. Therefore the plaintiff does not require a banking licence under the Banking Act to extend the said loan to the 1st defendants.

What Is a Development Bank or Development Finance Institution?

According to the *Bank Negara Malaysia's* 30th Anniversary Edn., of Money And Banking In Malaysia (1959-1989), development finance institutions are specialised financial institutions. They are established to promote a higher level of investment in industries and agriculture... Their functions include the extension of financial assistance in the form of medium and long-term loans... and the provision of guarantees for loans... The role played by development finance institutions tends normally to complement those of other major financial institutions. They specialise in medium and long-term capital financing as well as supply a range of financial services not normally provided by the commercial banks and the finance companies... Development finance institutions emerged in Malaysia, as in most developing countries, to fill a gap in the supply of financial services that are not usually covered by the established financial institutions... A significant problem faced by the development finance institutions in Malaysia has been the increasing competition posed by other financial institutions, which are becoming more development-orientated in outlook.

Cited in support by the plaintiff was the judgment of *Re-Haji Yahya Lampong Ex parte Sabah Development Bank Bhd.* [1987] 2 MLJ 488. That was a bankruptcy petition with the plaintiff as the judgment creditor. In that case, it was claimed that (at p. 491):

> ... the action of the judgment creditor was to recover the money due to them and this could not be called transacting banking business

as defined. Also cited were (i) *Bank Of China v. Lee Kee Pin* [1961] 1 MLJ 40, and (ii) *Bank Of China v. Chew Kean Kor* [1963] MLJ 41. The learned Judge in *Re-Haji Yahya Lampong* (*supra*) decided, after listening to the arguments and considering the evidence and the authorities that he was "satisfied" and he "accepted the affidavit of the general manager of the petitioning creditor that their activities **in respect of this transaction** (Capitals for emphasis) neither infringed s. 3 of the Banking Act as they do not come within s. 2 of that Act nor do they contravene s. 3 of the Finance Companies Act 1969, since their activities do not come within s. 2 thereof."

I proposed not to go into whether or not the transaction(s) infringed the Moneylenders Ordinance 1951 on two grounds:

(1) This was not contested; and

(2) I accepted the plaintiff's statement that it was exempted by gazette notification PU(B) 176 of 1986 from the provisions of the said Ordinance with retrospective effect from 9 August 1977.

Plaintiff did not however delve deeply into the "banking business", what it embodied and its implications, and Counsel neglected to discuss whether the plaintiff can conduct "banking business" and its relevance to the present action.

My finding at this stage is that even though a corporation or a company so described and registered under the Companies Act 1965, may have obtained consent from or is authorised by the Minister of Finance under s. 9 of the Banking Act 1973, such an organisation or so-called "bank" is not a bank and it does not become a bank within s. 2 of the Banking Act 1973. I have to deal with the Banking Act 1973 which was applicable at the time the loan(s) was/were made and became repayable. Section 9 dealt with restrictions of use of title "bank" and the use of certain words in a bank's name and it clearly spelt out that:

> ... a person or body of persons not being a licensed bank shall not assume or use in relation to the business or any part of the business carried on by the person or body of persons the word "bank" or any of its derivative or any word indicating the carrying on of banking business either in National Language or in English or in any other language" (except with the consent in writing of the Minister). The prohibition was against the use of the word "bank".

The plaintiff tendered Exhibit TSH1 whereon on 26 July 1978, the Minister of Finance gave consent to the plaintiff to use the word "bank" in its name. TSH2 copy of form of certificate of incorporation of public company dated 9 August 1977 together with the memorandum of association. Among the objects of the plaintiff are:

(i) to carry on any and every aspect of business of a development bank;

(ii) to carry on business as capitalists and financiers.

Plaintiff's Counsel cited *Vernes Asia Ltd. v. Trendale Investment Pte. Ltd. & Anor.* [1988] 1 MLJ 357 where the Singapore Banking Act was raised. In that case the plaintiff was a deposit-taking company incorporated in Hong Kong and had no office or place of business in Singapore. It was held (2):

> ... banking business" in s. 2 of the Banking Act means that a company can only be said to be conducting banking business if it performs all of the functions of receiving money on current or deposit account; paying and collecting cheques; making advances; and such other business as may be prescribed by the monetary authority of Singapore for the purposes of the Act. The Legislature did not intend the definition of "banking business" in the Banking Act to be construed disjunctively so that the making of advances to customers alone amounts to the conduct of banking business. Therefore, the plaintiff was not conducting banking business in Singapore.

In that case, it was not suggested on behalf of the defendants that the loan by the plaintiff to the 1st defendant in any way offended the provisions of the Deposit-taking Companies Ordinance (see p. 359). In our instant case, there was a challenge to the legality of the loan(s) and it has been suggested that the loan(s) offended against the Banking Act 1973. *Paget's Law Of Banking* (6th Edn.), at p. 8 states that:

> No one and nobody, corporate or otherwise can be a "banker" who does not:
>
> (i) take current accounts;
>
> (ii pay cheques drawn on himself;
>
> (iii) collect cheques for his customers.

In *Re-Roe's Legal Charge* [1982] 2 Lloyd's LR 370 the trial Judge held that the plaintiffs were carrying on the business of banking because the evidence showed they were doing all three of these acts.

In our case, there was no evidence that the plaintiff did any of the above. Evidence only showed the plaintiff made advances (one such was to the defendant - Facility 1) and provided documentary import credit facility of RM300,000 and (Facility 2) revolving credit line of RM200,000 for the issuance of letters of credit and import advance or trust receipt. Facility 1 was provided for the issuance of documentary sight/time letter of credit (LC) within limit of 30 days import advance (IA), and up to 60 days trust receipt (TR). Facility 2 - drawdown supported by promissory notes.

Mr Sugumar said that letters of credit and trust receipts are peculiar to banks only:

> Only commercial banks licensed under the relevant Acts carry on this particular kind of facilities.

The guarantee document stated that plaintiffs did grant "banking facilities". Even though the M & A of the plaintiffs may state several activities they can embark upon, the Court can find against them if they carried out banking business, that is take current accounts and pay and/or collect cheques.

One must also go back to basics and the basic item to determine whether or not the facilities come under banking business is to see the purpose - At p. 2 Clause 3 of Exhibit LCF1, it was clearly set out that the purpose was to facilitate SKBS's (that is the 1st defendants's) importation of electrical and mechanical equipment and for SKBS's general working capital purposes.

Defendants said it was a triable issue : the question of whether the loan was void in view of the fact that the plaintiff is not licensed as a bank under the Banking Act 1973 (now the Banking and Financial Institutions Act 1989).

Plaintiff contended that the loan could be under "provision of finance" and under the Banking Act it would be under "making advances". As for the issuance of letters of credit and trust receipts, Mr. Thien agreed that this may be peculiar to banks but there is no prohibition in law and such issuance is not the sole domain of the commercial banks.

Bank Negara Malaysia is the authority on banks and who can carry on banking business. In the book *Money and Banking In Malaysia* 1989, the plaintiffs was described as follows:

> The authorised capital initially was RM100 million, but was subsequently raised to RM200 million in 1982. The priority areas for financing included Bumiputera enterprises, agro-based and wood-based industries, and housing development. Since 1979, the bank had expanded its activities to cover both large-scale project financing and co-financing as well as trade financing, loans syndication and corporate finance and management services. The bank's activities were later expanded to leasing, hire purchase and mortgage finance. (It went) into retail banking after taking a minority shareholding interest in Sabah Bank Berhad in 1986. Prior to 1982, these loans were granted for the financing of manufacturing activities, especially of wood and wood products, metal and metal products, and transport equipment. But, after 1982, the emphasis was more on lending to the property development and real estate sector. In 1987, 37.5% of the loans outstanding was for property development and real estate, and 29% for agriculture. A smaller share of 5.3% was extended to the manufacturing sector, and another 3% to general commerce. In terms of maturity, 61.8% of the outstanding loans was extended in the form of loans of over five years maturity, while short-term loans of less than three years accounted for another 37.6% and medium-term loans with a maturity of three to five years accounted for the remaining 0.6%. The interest rates charged varied according to the

nature of loans, but a discernible decline in the mode rates was observed for most types of loans during 1987. During the year, the mode lending rates for construction and real estate development declined to 11.5%, agriculture to 11% and manufacturing to 10.5% per annum. Besides providing development finance, the bank was also engaged in the provision of fee-based services. This included loans syndication, corporate finance, and management advisory services for private and public enterprises in the State. Between 1979 and 1987, the bank led and co-led a total of 36 syndicated loans, with a cumulative value of RM1,100.5 million. Its share was RM173.3 million or 15.7%.

Order 14:

Defendants strongly claimed that by virtue of the transaction or loan being challenged as void, the summary judgment should not be ordered. In reply, the plaintiff quoted *Diversey (Far East) Pte. Ltd. v. Serva Pakar Kimia Bhd*., reported in the Writ Vol. IX 1990-91 p. 77 where at p. 84, the Court confirmed that it

> ... cannot see any triable issue at all among the many issues raised... the Court does not like to see any abuse of the process of the Court.

But to be fair to the defendants, the Court in the same action also stated that:

> Neither, of course, should Courts order summary judgment if one is not merited.

The facilities were extended on 31 January 1986 on the two letters of offer dated 30 March 1985 and 3 April 1985. The promissory notes were dated 1 October 1984, 16 November 1984 and 3 April 1985. The continuing guarantee was dated 2 April 1985. All these transactions and activities were regulated by the Banking Act 1973 during the period in question. The Banking and Financial Institutions Act 1989 (BAFIA) only came into force as from 1 October 1989. Financial institutions, according to *Money and Banking In Malaysia*, Bank Negara Malaysia (1959-89) at p. 204 include "the banks, the finance companies and institutions such as the MIDF and Sabah Development Bank."

The part where the plaintiff involved itself in letters of credit or trust receipts disturbed me in that such transactions involve foreign exchange which each bank (or organisation) must clear with Bank Negara Malaysia. It would appear that the plaintiff is a scheduled institution (s. 2(1) of BAFIA) as it carries out scheduled business of development finance business. See s. 3 of BAFIA's third schedule. In the absence of any evidence that Bank Negara or other regulatory authority has disapproved the plaintiff's activities, I shall presume plaintiff conducts its business in accordance with the laws and regulations of Malaysia and therefore it has not breached the Banking Act 1973 (or the Banking and Financial Institutions Act 1989 where applicable).

The activities of licensed institutions and other corporations can be regulated by Bank Negara, for example deposit-taking restrictions imposed on finance companies and merchant banks have been reduced substantially recently. This is merely to illustrate that the activities of those bodies under the Banking Act or BAFIA can change from time to time.

In line with the evidence and the arguments on the points of contention, I cannot see how plaintiff has breached the law as it did not conduct banking business by lending to defendant. *Vernes Asia Ltd.* (*supra*) is clearly in support of this. Accordingly, I grant an order-in-terms of plaintiff's claims and I order accordingly.

Also found at [1991] 3 CLJ 2941